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TREASURY FOR DPETERS, RHALL, RABDULRAZAK
STATE PASS USTR FOR LISER, AGAMA
STATE PASS OPIC FOR ZHAN, MSTUCKART, JEDWARDS
STATE PASS TDA FOR EEBONG, DSHUSTER
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SUBJECT: Nigeria: Experts Say Nigerian Economy Faring Better Than Others in Global Crisis

¶1. (U) Summary: On December 11, Economic Associates (EA), a firm of economists reviewed the Nigerian economy in 2008 at its annual economic outlook session in Lagos. EA analysts said commodity prices, particularly oil, are Nigeria's major link to the global economy, although a dearth of foreign capital inflows due to the credit crunch in the West contributed to the deflation of domestic stock prices. That being said, they see the slowdown in the Nigerian stock market as part of the a normal cycle in tune with global trends, although they believe Nigeria fared better than other emerging markets whose economies are more integrated with the West and that asset substitution, induced by higher interest rates of bonds and bank deposits had sustained the stock market slowdown. Household spending has been dropping as incomes have been eroded by the low minimum wage and inflation. End summary.

Commodity Price Links Nigeria to Global Economy
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¶2. (U) On December 11, Economic Associates (EA), a firm of economists that studies trends and develops models on the Nigerian economy, held it annual economic outlook session to forecast Nigeria's fortunes in 2009. EA analysts said commodity prices, particularly oil, link Nigeria more closely to the global economy than the Government of Nigeria (GON) wanted to believe. Tayo Fabusuyi, EA's principal economist, said global cyclical swings get transmitted to the domestic economy through commodity prices and their outturns are the leading foreign indicators of the Nigerian economy. He said global oil price predicts Nigeria's fiscal situation, external reserves and exchange rate. As an example, he pointed to the oil price slide to USD40.68 in December, lower than the USD45 oil price used as a benchmark for determining the GON's 2009 budget. In the first week of December, the naira depreciated by 10 naira to the USD (Reftel).

Nigeria Economy Fares Better Than Its Peers

¶3. Fabusuyi said Nigeria has so far fared better than most emerging markets whose economies are more integrated with the West. Based on second quarter 2008 data, Nigeria's Gross Domestic Product (GDP) growth of 6.4 percent was higher than the 4.5 percent average growth for 26 emerging market economies (EME) including China, India and Russia. Consumer price inflation data for Nigeria (14.7 percent) in October was higher than the EME average of 9.8 percent. However, its external reserves of USD 58.4 billion fell below the USD 167.6

billion EME average skewed upward by China's USD 1,905.6 billion reserves. Ayo Teriba, CEO of Economic Associates, said relative to other emerging markets, the Nigerian Stock Exchange (NSE) has been able to hold its own in the midst of the present global crisis. While the average contraction in EME stock markets was 46.2 percent, the NSE had only lost 17.6 percent of its capitalization as at November 2008 (Reftel).

Foreign Capital Decline, Asset Substitution
Trigger Stock Market Slide

¶4. (U). According to Teriba, the downturn in the NSE is cyclical and in tune with global trends, although it came later and was milder than in other EMEs. He said the inflow of foreign capital had lowered interest rates, made fixed rate assets unattractive and boosted the NSE. The contraction of credits in the West caused such capital inflows to dry up, drive up bank rates and deflate the NSE. Teriba believed the recent hand-wringing over the stock market decline may have been exaggerated. The story within the local economy is one of asset substitution, he said, because an increase in bond and money market instruments rates makes them more attractive to investors than equities. A situation of zero-sum game may be at play; equity losses are gains for bond markets and bank deposits, and a reversal will occur when interest rates fall, Teriba said.

Interest Rate Hike Sustained Market Downturn

¶5. (U) EA analysts observed that the volume of demand deposits have

increased by more than two trillion naira (USD 15 billion) in the past 10 months since the NSE downturn began, coinciding with a period of interest rate rise in the money market. According to EA, when the NSE started growing, currency outside banks (COB) was high because inflation was higher than the interest rate and people preferred to hold cash or invest in the NSE. Bank deposits were low, until the NSE capitalization plunged in March 2008, when the growth of bank deposits accelerated doubling from naira 4 trillion (USD 30 billion) in December 2007.

¶6. (U) Teriba noted that although the slowdown at the NSE may have been triggered by policy statements from financial sector regulators (Reftel), the downturn was largely sustained by the continued rise in interest rates. Although the Central Bank of Nigeria (CBN) had reduced its interest rate benchmark, the Monetary Policy Rate (MPR), in September in an attempt to stem stock prices deflation, the increase in GON debt instruments, particularly medium to long term bonds issued at 10-15 percent interest rate, gave NSE investors an alternative investment destination. He noted that rates on bonds of longer term maturities have been in double digits since the first quarter of 2008 as government was willing to pay higher interest rates in order to make bonds attractive.

Bonds, CBN Withholding May Stall Stock Rebound
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¶7. (U) EA commended the GON for successfully deepening the long term end of its domestic debt through the issuance of 10-20 year bonds, but claimed the move may stall the timely recovery of the stock market. Teriba noted that while CBN's holdings of GON debt instruments have declined in recent years, commercial banks' holdings have surged. At the same time CBN's holding of government deposits has surged, while commercial banks are holding fewer government deposits. He said banks' loanable funds are being 'depleted' on two fronts; they have funds tied down in bonds and have no access to public funds; as a result they may not be able to actively help the stock market rebound. Teriba suggested that public funds be made available to commercial banks, even on a temporary basis, at a fixed interest rate in the medium term to help make funds available to the stock market. He advised the CBN to help banks restructure the maturity of their deposits in the same way the Debt Management Office (DMO) is helping the GON restructure the maturity of its debt instruments.

Households Spend Less; Business, Government More
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¶8. (U) Teriba noted that whereas private consumption accounted for 87.4 percent of GDP in 2003, it dropped to half that percentage in 2007, largely because income of the average Nigerian household is heavily depressed by a national wage policy, based on a minimum wage of naira 7,500 (USD57), last reviewed in 2000 and highly eroded by inflation. The Nigerian is not able to afford much beyond food, clothing and essentials like utilities and transportation. In the face of stable net export growth, the over 44 percent decline in household spending has been offset by booming businesses whose capital spending rose by 42 percent in the last five years, and by a growing government sector, which spends about 25.8 percent of GDP. Teriba called this a delicate macroeconomic balancing act, in the face of peculiarities of the Nigerian economy, for two reasons: weak demand might initiate over-capacity as well as large inventory for firms, and empty consumer purses might incite social and political revolt against the government. Teriba advised government to pass on resources to households by reforming its wage policy and raising minimum wage.

EA Criticizes USG Response to Global Crisis

¶9. (U) EA analysts criticized the United States Government's response to the current global crisis, saying the response to the Asian crisis was swifter and more reassuring. They critiqued the USD 700 billion bailout as arbitrary, saying that the existing stocks on the US market are highly leveraged and are likely to crumble. The analysts believe that the bailout was mainly to boost confidence and reassure investors and consumers that there is a level below which

the USG will not allow the crisis to go, rather than to solve the problem. They opined that the panic in the last four months created the major problem and not the financial crisis which had been on for over a year. EA predicts that the US will come out of the economic crisis by second quarter 2009, faster than the Asian Tigers did, although the financial crisis might linger.

¶10. (U) This cable has been cleared by Embassy Abuja.
HUDSON